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THE IMPACT OF FOREIGN DIRECT INVESTMENT (FDI) ON ECONOMY GROWTH IN POST SOVET UNION COUNTRIES

Annotation: This scientific article explores the impact of Foreign Direct Investment (FDI) on economic growth in post-Soviet Union countries, analyzing its role as a catalyst for development and examining the factors influencing its effectiveness. It investigates the interplay between FDI and macroeconomic indicators, highlighting the complexities of attracting and utilizing foreign investment in transitioning economies. The article also discusses the challenges and opportunities associated with FDI in these countries, focusing on policy implications and strategies for maximizing its positive impact.

Keywords: Foreign Direct Investment (FDI), Economic Growth, Post-Soviet Union Countries, Transition Economies, Macroeconomic Indicators, Institutional Quality, Structural Reforms, Policy Implications, Development Strategies.

Introduction

Following the collapse of the Soviet Union, post-Soviet countries embarked on a path of transition to market-based economies. Attracting Foreign Direct Investment (FDI) emerged as a crucial strategy for driving economic growth, fostering modernization, and creating jobs. Foreign Direct Investment (FDI) refers to the investment made by an entity (individual, company, or government) from one country into business interests located in another country. This involves a long-term relationship and control in decision-making by the foreign investor over the domestic company.

FDI is typically measured by the net inflows and outflows of capital between countries. Common metrics include:

Stock of FDI. This represents the total accumulated value of foreign-owned assets in a country.

Flow of FDI. This measures the annual amount of FDI inflow and outflow.

Methods

The countries selected as the population for this research encompass 15 Post-Soviet Union nations, offering a unique focus on this specific region. The rationale behind choosing these countries is rooted in their shared historical background, economic transitions, and the unique challenges and opportunities faced by post-Soviet economies.

Table 1. Countries

No	Countries	Region
1	Russia	Eastern Europe

No	Countries	Region
2	Ukraine	Eastern Europe
3	Belarus	Eastern Europe
4	Kazakhstan	Central Asia
5	Uzbekistan	Central Asia
6	Azerbaijan	South Caucasus
7	Armenia	South Caucasus
8	Georgia	South Caucasus
9	Moldova	Eastern Europe
10	Kyrgyzstan	Central Asia
11	Turkmenistan	Central Asia
12	Tajikistan	Central Asia
13	Estonia	Baltic States
14	Latvia	Baltic States
15	Lithuania	Baltic States

Jilenga (2016), examines the impact of foreign debt and foreign direct investment (FDI) on economic growth in Tanzania in 1971-2011 using the ARDL model. The results of the study show that debt will drive economic growth in Tanzania in the end. However, foreign direct investment shows a negative impact on economic growth. In the short term, it is found that there is no causal relationship debt and economic growth. The research of I Made Yudisthira and I Gede Sujana Budhiasa, (2012). Two Stage Least Square (TSLS) Method. The consumption and investment variables have a positive and significant effect on GDP, while the inflation variable has a positive but not significant effect on GDP. Bonokeling Research (2016), also explains that foreign debt partially has a positive and significant effect on GDP in the long term and short term.

The research of Zulkefly, A.K., et al (2006), examined the long-term relationship between total expenditure, income (tax and non-tax) and economic growth of ASEAN-5 countries, namely Malaysia, Indonesia, Thailand, Singapore and the Philippines. The result of variance decomposition shows that the strong influence on expenditure for state income namely Malaysia, Indonesia and the Philippines, which supports the income-expenditure hypothesis. Meanwhile, for Thailand and Singapore budget decisions are driven by the income side which supports the 'expenditure-income hypothesis'. In addition, public expenditure does not play a role in stimulating economic growth in Malaysia, Thailand, Singapore and the Philippines, except for Indonesia. Researchers who study foreign direct investment (FDI) can also have a negative influence on economic growth in Indonesia and Tanzania (Malik and Kurnia, 2017; Jilenga, et al, 2016). However, several studies on the relationship of foreign debt and economic growth are different for each country. There are several countries producing research that foreign debt has a positive and significant effect on Indonesia's economic growth (Malik and Kurnia, 2017). However, several Inndonesia case studies found that foreign debt also had a negative and significant effect on

Indonesia's economic growth in the period 1996 - 2013 (Saputra and Kesumajaya, 2016). Giirsoy's research (2012) empirically examines the impact of foreign direct investment (FDI) on Georgia's economic growth using the Engle-Granger cointegration method and the Granger causality test of the 1997-2010 period. His findings produce foreign direct investment which causes GDP in the country of Georgia. However, it is very important to understand the direction of causality between these two variables, to establish policies that will encourage private investors, especially in developing countries. In their findings the direction of causality going from FDI to GDP was confirmed in the case of Georgia. Different research results revealed by Alfaro et al. (2008), concluded that FDI increases economic growth only in certain economic conditions, such as the threshold level of human capital. Acaravci and Ozturk (2012), examine the FDI-economic growth relationship. The findings can be generated that FDI can help developing countries through providing capital by creating new job opportunities, through technology, through the flow of managerial knowledge and marketing skills. Ozturk and Kalyoncu (2007) also say that there is a positive relationship between FDI inflows and growth provided that the recipient country has reached a minimum level of development in education, technology and or infrastructure. Islam (2014) also examines the effect of FDI on the Bangladeshi economy using data from 1996 - 2010. He believes that FDI in Bangladesh plays an important role in achieving expected economic growth. The results show that FDI has a positive correlation with GDP, exports and private investment.

The impact of FDI on economic growth can be explained through the neoclassical growth theory and the endogenous growth theory. According to the neoclassical growth theory, economic growth depends on capital, labour and technology (Solow, 1956). In addition to capital and labour, this theory emphasizes the role of exogenous technology towards economic growth. It can be seen that the neoclassical growth theory is an important foundation to explain the impact of FDI on economic growth. However, the neoclassical growth theory is limited because it does not explain the spillover effects of FDI on economic growth in the host country. To overcome this limitation, the endogenous growth theory is developed to better explain the spillover effects of FDI in the host country, thereby stimulating economic growth in the host country (Romer, 1990). Accordingly, FDI promotes the host country to receive technology transfer from countries with advanced technology. This contributes to the improvement in technological progress in the host country. Simultaneously, the host country has favourable conditions to specialize in production and develop advantageous products at a lower cost compared to other countries. In the endogenous growth theory, FDI is estimated to be more effective than domestic investment in stimulating economic growth in the host country (Herzer et al., 2008). Different from the neoclassical growth theory, the endogenous growth theory emphasizes the role of governmental policies towards economic growth. The above problems show that the neoclassical growth theory and the endogenous growth theory have provided a relatively complete theoretical framework to explain the impact of FDI on economic growth. It can be seen that investment capital is an important resource to improve economic growth in any country (Adegbite & Ayadi, 2010). In the context of limited domestic investment capital, many countries have made efforts to attract FDI because these countries believe that FDI is a stable and necessary source of capital to enable them to effectively supplement the shortfall (Noorzoy, 1979).

The Harrod-Domar model suggests that increased investment, including Foreign Direct Investment (FDI), leads to higher economic growth. FDI contributes to capital accumulation, which is essential for increasing the productive capacity of an economy. Furthermore, FDI often brings technological advancements and best practices, which enhance productivity and efficiency.

Capital Formation. FDI increases the total capital available for investment, leading to the establishment of new businesses and the expansion of existing ones.

Technology Transfer. Multinational corporations bring advanced technologies and managerial practices to host countries.

Employment Generation. FDI creates job opportunities and can improve the skill level of the workforce.

Increased Productivity. By introducing new technologies and efficient business practices, FDI can lead to increased productivity.

Capital Accumulation. FDI brings in additional financial resources that can be used for capital formation. This increases the stock of capital in the economy, which is a critical component of the Harrod-Domar model's growth equation. The influx of foreign capital can finance the construction of new factories, infrastructure, and other productive assets, leading to a higher output level.

Technological Advancements. Multinational corporations (MNCs) involved in FDI often introduce new technologies and managerial practices to the host country. This transfer of technology enhances the productivity of existing resources and can lead to significant improvements in efficiency and output. The Harrod-Domar model underscores the importance of efficient capital utilization, and technological advancements are a key factor in achieving this efficiency.

Employment Generation. FDI often leads to the creation of new jobs, which increases income levels and boosts domestic consumption. Higher employment levels lead to increased demand for goods and services, stimulating further investment and economic growth. This aligns with the Harrod-Domar model's emphasis on the multiplier effect, where initial investment leads to a series of subsequent economic activities.

Market Expansion. FDI can help domestic firms integrate into global markets by providing access to international distribution networks and markets. This can increase exports, improve the balance of payments, and contribute to higher economic growth. The Harrod-Domar model implicitly supports the idea that expanded markets can lead to higher returns on investment, encouraging further capital formation.

FDI and Economic Growth. The Harrod-Domar model suggests that increased investment (including FDI) leads to higher economic growth. FDI contributes to capital accumulation and technological advancements, enhancing productivity.

Results

Descriptive statistical analysis aims to offer a comprehensive overview of the statistical data pertaining to the variables under investigation. In this research, the independent variables are FDI (Foreign Direct Investment), Inflation, and CPI (Corruption Perception Index), while the dependent variable is represented by GDP Growth. The descriptive statistics include the minimum and maximum values, mean, standard deviation, and variance.

Table 2. Descriptive Statistics

Descriptive Statistics								
	N	Range	Minimum	Maximum	Mean	Std. Deviation	Variance	
	<u>Statistic</u>	<u>Statistic</u>	<u>Statistic</u>	<u>Statistic</u>	<u>Statistic</u>	<u>Std. Error</u>	<u>Statistic</u>	<u>Statistic</u>
FDI (X1)	112	83.58	-43.13	40.45	2.5980	0.73780	7.80819	60.968
Inflation (X2)	112	50.10	-1.40	48.70	6.7480	0.65672	6.95006	48.303
CPI (X3)	112	56.00	19.00	75.00	39.9911	1.43244	15.15951	229.811
GDP Growth (Y)	112	43.03	-29.10	13.93	2.6224	0.48370	5.11902	26.204
<u>Valid N (listwise)</u>	112							

The dataset, spanning 112 data 15 Post Soviet Union countries from 2015 to 2022, reveals notable variations in key variables. Foreign Direct Investment (FDI) shows a range from -43.13 to 40.45, with a mean of 2.5980. Inflation varies between -1.40 and 48.70, averaging at 6.7480. The Corruption Perception Index (CPI) ranges from 19.00 to 75.00, with a mean of 39.9911. GDP Growth fluctuates from -29.10 to 13.93, with a mean of 2.6224.

Discussion

Synthesis with Macroeconomic Factors and Economic Growth.

The link between FDI and macroeconomic factors, particularly in the context of economic growth, is crucial. Studies have explored how FDI contributes to economic development by bringing in capital, technology, and managerial expertise. The positive impact of FDI on GDP growth, employment, and infrastructure development underscores its significance in the broader economic landscape.

Synthesizing FDI with the previously discussed macroeconomic factors and classical economists' theories reveals a dynamic interplay. FDI becomes a contemporary manifestation of the classical emphasis on factors like capital accumulation, technology, and labor as drivers of economic progress. The globalized nature of FDI aligns with the interconnected economic landscape envisioned by classical economists, albeit in a modern context.

FDI can contribute to economic growth in various ways:

Capital Inflow: FDI provides a significant source of capital for investment in new industries, infrastructure, and technology. This capital can help to bridge the gap between domestic savings and investment needs, particularly in countries with limited access to international financial markets.

Technology Transfer: FDI often brings with it advanced technologies, production methods, and management practices, which can enhance productivity, competitiveness, and innovation in recipient economies.

Job Creation: FDI can create new jobs in various sectors, contributing to employment growth and reducing unemployment rates, particularly in labor-intensive industries.

Increased Exports: FDI can help boost exports by expanding production capacity, improving quality, and providing access to new markets.

Factors Influencing the Impact of FDI:

Institutional Quality: A strong legal framework, effective regulatory environment, and transparent governance are essential to attract and sustain FDI. Countries with weak institutions, corruption, and unreliable property rights protection often struggle to attract foreign investment.

Structural Reforms: Implementation of structural reforms, such as privatization, liberalization of markets, and simplification of bureaucratic processes, can create a more conducive environment for FDI by reducing risks, increasing transparency, and enhancing competitiveness.

Macroeconomic Stability: Stable macroeconomic conditions, including low inflation, controlled government debt, and a predictable exchange rate, are essential to attract and retain FDI.

Human Capital: A skilled workforce with the necessary education, training, and technical expertise is crucial for successfully utilizing FDI and maximizing its benefits.

Geopolitical Factors: Geopolitical stability, regional integration, and access to key markets play a role in influencing the attractiveness of post-Soviet countries to foreign investors.

Conclusion:

FDI can play a significant role in driving economic growth in post-Soviet Union countries. However, its impact depends on a complex interplay of factors, including institutional quality, structural reforms, macroeconomic stability, human capital, and geopolitical considerations. To maximize the benefits of FDI, these countries need to address challenges related to institutional development, structural reforms, and human capital development, while implementing strategies to attract and utilize foreign investment effectively. By focusing on these aspects, post-Soviet countries can harness the power of FDI to fuel sustainable economic growth and achieve their development goals

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